

National Tariff Policy 2019-24



November 19, 2019

**Commerce Division
Ministry of Commerce & Textile**

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1. Introduction

During the last two decades, the global epicenter of growth has been gradually shifting to Asia, specifically in Pakistan's proximity. Since 2003, the global market share of Pakistan's neighbouring countries, China, India, Iran and Afghanistan (CIIA), has increased by 216%, that of SAARC region by 186% and ECO by 127%. During the same period, Pakistan's share in global market has decreased by 19%. Had Pakistan's exports grown at the pace of CIIA, her annual exports in FY 2019 would have been US\$ 55 billion instead of US\$ 23 billion. The failure to keep pace with the regional export growth is primarily linked with anti-export bias in Pakistan's economic policy paradigm, the tariff regime on imported inputs being one of the major drivers of anti-export bias.

Pakistan's export growth since FY2001 has been commensurate with tariff liberalization. The applied weighted mean tariff in Pakistan was reduced from 23.1% in FY2000 to 8.9% in FY2014. During the same period, exports increased by 173% from US\$ 9.2 billion to US\$ 25.1 billion. Since FY2014, the tariff liberalization has been reversed by gradually increasing the applied tariff to 11.6%, which resulted in decline of exports to US\$ 23 billion in FY2019.

It is globally acknowledged that the import tariffs, employed effectively, can play a vital role in optimal allocation of resources, removal of anti-export bias, protection of domestic industry, improving competitiveness, attracting and protecting investments, and improving balance of payments, serving as a source of revenue and income distribution by levying higher import duties on luxury goods and lowering tariffs on raw materials and intermediate goods.

On the other hand, employed excessively, the tariffs erode competitiveness of industry by increasing cost of inputs, cause de-industrialization by making industrial investment less viable due to eroded competitiveness, breed incompetence by protecting the inefficient producers, impose costs on consumers by making industrial products expensive, and create anti-export bias by making the domestic market more attractive than exports. The fact that the economy witnessed de-industrialization with the share of industrial production going down from 26.4% of the GDP in FY2010 to 20.3% in FY2019, and the share of exports going down from 13.5% of GDP in 2010 to 7% in 2019, demonstrates the adverse impact of higher tariffs on the economy.

2. Pakistan's Tariff Regime

In Pakistan, the import tariffs are traditionally employed as a revenue generation tool rather than instrument of trade policy as import tariffs are easy to levy and administer than direct taxes.

Pakistan had gradually liberalized tariffs, though with occasional increases in tariff protection from time to time. The number of general tariff slabs were gradually reduced from ten (10) in 1993 to six (6) in FY2015. The maximum tariff was reduced in FY 2015 to 25%; on the other hand, 1% duty was imposed on the 40% tariff lines, mainly essential raw materials and machinery, which were hitherto exempted from duty. In FY2016, the number of slabs was further reduced to 5 and the maximum tariff was reduced to 20%; on the other hand, the lowest slab was increased from 1% to 2%. In FY2017, the slabs were reduced to four, by merging the slab of 2% and 5% and creating a new slab of 3%. It increased the import tariff on raw materials and machinery from 0% in FY2014 to 3% in FY2017. An additional duty of 1% was levied under SRO 1178(I)/2015, which was increased to 2% in FY2018.

In the Finance Act FY2018, the tariff on 236 raw materials, primarily of export-oriented industry, was reduced on Commerce Division's request. In the two supplementary budgets announced during the same financial year, the duty on 80 and 106 additional tariff lines was reduced. In the Finance Act FY2019-20, tariff on 1635 tariff lines comprising raw materials and capital goods was reduced from 3% to zero. However, an additional customs duty on the slab of 16% and 20% was increased by 2% and 5% respectively.

The current four duty slabs are 3%, 11%, 16% and 20%, with a large number of tariff lines subject to additional duty of 2%, 4% to 7%. Currently, the following tariff slabs exist:

Duty Slab	No. of Tariff Lines	Value of Imports (US\$ billion)
3%	2,747	24.2
11%	1,096	11.1
16%	513	2.5
20%	2,419	7.1

Regulatory duties, have also been adopted, as another instrument for revenue generation in addition to the above-mentioned customs duties.

To facilitate the manufacturers-cum-exporters, a number of schemes are in place to waive/reimburse the import duty on their inputs; however, the benefits of such schemes are availed only by very few exporters. Many exporters especially SMEs often fail to avail the benefits of such exemption schemes or duty drawbacks.

Besides, the large number of concessionary Statutory Regulatory Orders (SROs) and Customs General Orders (CGOs) were issued from time to time to provide concessions and exemptions. Realizing the complexity and distortions created by the SROs, the government started phasing out the concessions since July 2014. Instead of discontinuation, a large number of such concessions were moved to the Fifth Schedule of the Pakistan Customs Tariff. Also, the powers of the FBR to issue such concessions were withdrawn.

3. Institutional Responsibility of Tariff Setting

Under the Federal Government Rules of Business, 1973, the Tariff policy and protection regime is the mandate of the Commerce Division. Accordingly, the Commerce Division has been administering the trade defence laws (related to Anti-Dumping, Safeguards and Countervailing Duties) through the National Tariff Commission, negotiating tariff concessions under the bilateral and multilateral arrangements and formulating the National Trade Policy, of which tariffs are the primary instrument.

However, over the years, due to the revenue constraints, the role of tariff setting has been gradually assumed by the FBR, which has employed it as a revenue instrument, thereby creating multiple layers of policy distortions and adversely affecting the export competitiveness.

4. Issues in Tariff Regime

There are several issues created by the current tariff regime:

- (i) Employment of import tariffs as a revenue tool, has created multiple distortions and affected the competitiveness of manufacturing, especially the export-oriented sector, the higher import tariffs on imported raw materials, intermediate goods and machinery has increased the cost of inputs.
- (ii) The sustained high level of tariff protection has created inefficiencies in the manufacturing sector, which is unable to protect its share in the domestic market, not to speak of competitiveness in the global market.

- (iii) The high tariffs have created an anti-export bias, as the producers of goods find export markets less attractive than the protected domestic market. The burden of the protection is borne by the domestic consumers since domestic prices for the protected items are maintained above international market prices.
- (iv) Multiple duty slabs, high tariffs, concessionary SROs and regulatory duties have made the tariff structure complex.
- (v) The high tariffs have increased the incentive for smuggling, under-invoicing and mis-declaration of quantity and quality of goods.
- (vi) There are intra-sector anomalies and discriminations since for several raw materials the tariffs for industrial and commercial importers are different. It has created bias against the SMEs who cannot import raw materials themselves and rely on commercial importers for sourcing their inputs.
- (vii) Frequent imposition of regulatory duties has made the tariff structure inconsistent and unpredictable, which hinders investment decisions.
- (viii) The replacement of 0% duty slab, covering primarily the raw materials and machinery, with 3% slab (plus 2% additional duty) has adversely affected the competitiveness of the manufacturing sector.

5. Regional Trends

The experience of developing countries demonstrates that the pace of development in those countries, which have undertaken programmes of structural reform, tariff rationalization and trade liberalization, was faster than the others. During the last decade, all the 20 fastest export-growth economies have reduced import tariffs, while in Pakistan the trend has been the opposite with an increase of 11% in import tariffs¹. Additionally, the imposition of regulatory duties has increased the effective tariffs even higher.

Currently, Pakistan maintains the highest average weighted tariff amongst the 70 countries having more than US\$ 20 billion annual exports.

Due to the inability of the tax machinery to collect direct taxes, the reliance on taxes collected in Pakistan at import stage has become alarming. The tariffs collected at import stage constitute around 48% of Pakistan's total tax revenues compared with the export driven economies e.g.

¹ World Bank

Malaysia (1.6%), Turkey (2.4%), Indonesia (2.6%), South Korea (3.2%), Thailand (3.9%) and China (3.9%) and India (12.8%)².

Pakistan's weighted average mean tariff of 12.7% is the highest amongst the top-70 exporting countries in the world. In comparison, the weighted average tariff of top-70 exporting nations is 2.7%, global average 2.6%, South Asian average 5.9%, ASEAN average 2.5%, China 3.8% and India's 5.8%³.

6. Tariff Policy

6.1 Objectives

National Tariff Policy aims to achieve the following objectives:

- i) To **improve competitiveness** of manufacturing, including the export sector, through duty free access to imported raw materials by rationalizing the tariff structure;
- ii) To **increase employment opportunities** by attracting efficiency-seeking investment in the manufacturing sector by making tariff regime transparent and predictable;
- iii) To lessen the distortions in the domestic price structure and **improve consumer welfare** by reducing the burden of excessive protection;
- iv) To **remove anomalies in the tariff structure**, which is causing distortions between sectors and in the value chain of the same sectors.

6.2 Principles

The Policy is based on the following principles:

a) **Tariffs as trade policy instrument**

The tariff policy will be employed as an instrument of trade policy rather than revenue. The tariffs will be leveraged for creating the right balance between trade liberalization and time-bound protection.

b) **Simplification**

The tariff structure will be simplified by reducing exemptions and concessions.

c) **Cascading**

² Ibid.

³ Ibid.

The principle of vertical consistency through cascading tariff structures (increasing tariff with stages of processing of a product) will be retained so that at any point in time, tariffs on inputs are lower than (or at least equal to) the tariff on the finished product. Besides, the steepness in escalation of tariffs will be reduced.

d) Strategic Protection

The domestic industry will be provided ‘strategic protection’ against the foreign competition during the infancy phase keeping in view the cost of doing business. The protection will be time-bound and phased out, so as to make the industry globally competitive.

e) Competitive Import Substitution

The size of domestic market will be leveraged for development of competitive import substitution industry. The time-bound protection will be provided in the domestic market, which will be phased out to make the industry competitive for export-oriented production.

6.3 Policy Guidelines

In order to achieve the above-mentioned objectives, the following tariff policy reforms are proposed:

- (i) These policy recommendations will be implemented in a period of five years starting from the Budget 2020-21;
- (ii) The tariff slabs will be simplified based on the principle of cascading;
- (iii) The tariffs on raw materials, intermediate and capital goods will be gradually reduced;
- (iv) The additional customs duty and regulatory duties will be gradually reduced;
- (v) The difference in the rates of tariff for the commercial importers and the industrial users of raw materials, intermediate and capital goods will be eliminated to reduce misuse of such differentials and to provide access to such essential materials for SMEs.
- (vi) The nascent industry will be provided time-bound protection, which will cover the payback period of financing and investment. The protection will be phased out gradually to make the protection regime predictable and facilitate the investment decisions. Such protection levels will be provided through Investment Policy.
- (vii) In order to implement these policy recommendations, the following arrangement will be instituted:

- a. A Tariff Policy Board (TPB) chaired by the Commerce Minister/Advisor, with Minister for Industries & Production, Secretary Finance, Secretary Revenue, Chairman FBR, Secretary Commerce, Secretary Board of Investment, and Chairman NTC as its members shall be created. Secretary Commerce shall be the Member/Secretary of the Board. The TPB shall be responsible for formulation, amendment and implementation of the National Tariff Policy.
 - b. A Tariff Policy Centre shall be created in the Ministry of Commerce, which will serve as the Secretariat of the TPB.
 - c. All proposals for levy, amendment or removal of tariffs including regulatory duties and customs duties shall be examined at the Tariff Policy Centre and after approval of the Tariff Policy Board shall be submitted by the Commerce Division to the Cabinet or Parliament, as the case may be, for approval.
- (viii) Any policy impacting tariffs or having tariff-like impact shall be formulated through the process mentioned at (vii) above.
